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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	CC Docket No. 99-249
Low-Volume Long Distance Users	)	
	)	

INITIAL COMMENTS OF THE KENTUCKY PAYPHONE ASSOCIATION, MICHIGAN PAY TELEPHONE ASSOCIATION, and the PAYPHONE ASSOCIATION OF OHIO

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Dated: September 20, 1999

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The Kentucky Payphone Association, the Michigan Pay Telephone Association and the Payphone Association of Ohio (these payphone associations are together referred to herein as the "State Payphone Associations") submit the following comments in response to the Federal Communications Commission's ("FCC") Notice of Inquiry in this matter, released on July 20, 1999.

SUMMARY

The State Payphone Associations urge the FCC to initiate a rulemaking proceeding to revise its existing rules and regulations that allow local exchange carriers to impose subscriber line charges ("SLC") and presubscribed interexchange carrier charges ("PICC") for access services purchased by payphone service providers ("PSPs.") The existing regulations that allow LECs to recover SLCs and PICCs on payphone access services contravene the FCC's regulations adopted pursuant to 47 U.S.C. § 276 in the FCC's *Payphone Reclassification Proceeding.*[1] In the FCC's *Payphone Reclassification Proceeding*, the FCC ordered that access services purchased by payphone providers from local exchange carrier be cost-based, and comply with the new services test pricing guideline set forth in 47 C.F.R. §61.49. The existing PICC and SLC regulations are intended to allow the LECs to recover a portion (the interstate portion) of the loop costs incurred in providing access services. However, the existing rates charged by Ameritech, GTE and BellSouth in Michigan, Ohio and Kentucky for COCOT[2] and Coin Line services are set to allow these LECs to recover over 100% of the entire cost (both interstate and intrastate allocated costs) of providing the services, plus a reasonable amount to recover a portion of the common expenses of the firm. With the addition of the PICC and EUCL charged by LECs on payphone access services, the LECs double-recover the common line costs incurred in providing services to PSPs. While such a policy may be appropriate for implicit and explicit subsidies between business and residential customers, the FCC's Payphone Orders require that LECs recover only the cost of providing PSP access services, plus a reasonable amount for overhead. The current access charge reform regulations contravene the FCC's cost-based pricing measures

1 *See Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Notice of Proposed Rulemaking, 11 FCC Rcd 6716 (1966) (*NPRM*); Report and Order, 11 FCC Rcd 20541 (1996) (*First Report and Order*); Order on Reconsideration, 11 FCC Rcd 21233 (1996) (*First Report and Order on Reconsideration*) (together the *First Report and Order* and the *First Report and Order on Reconsideration* are referred to as the *Payphone Orders*). The *Payphone Orders* were affirmed in part and vacated in part. *See Illinois Public Telecomm. Ass'n v. FCC*, 117 F.3d 555 (D.C. Cir. 1997) (*"Illinois Public Telecomm."*). The Commission addressed the issues remanded by *Illinois Public Telecomm.* in the Second Report and Order, 13 FCC Rcd 1778 (1997) *(Second Report and Order*). The *Second Report and Order* was also appealed. On appeal, the Court remanded certain issues to the Commission. *See MCI Telecomm. Corp. et al. v. FCC*, 143 F.3d 606 (D.C. Cir. 1998) (*MCI v. FCC*). The Commission addressed the issues on remand in The Third Report and Order, CC 99-7, Rel. February 4, 1999 (*Third Report and Order.)*

2 Customer Owned Coin Operated Telephone service and Coin Line services are access services purchased by payphone providers to provide telephone service to payphone provider customers.

adopted in the *Payphone Classification Proceeding.*

The State Payphone Associations urge the FCC to reevaluate its PICC and SLC regulations as they apply to PSPs, and to consider whether it is appropriate to adopt a payphone-specific PICC and a SLC specific to payphone access lines.

ARGUMENT

Section 276 of the Federal Communications Act, 47 U.S.C. § 276, directs the Commission to promulgate regulations that will achieve three basic policy objectives with respect to the provision of payphone services: (1) promoting a competitive payphone market; (2) ensuring the widespread deployment of payphones for the benefit of the general public; and (3) ensuring that providers of payphone services receive fair compensation for every call made using their payphones. Section 276 further instructs the Commission to establish these regulations in a pro-competitive, deregulatory framework that will open telecommunications services to competitive forces nationwide. The Commission has taken several steps that are minimally necessary to develop the framework for effective competition in the payphone industry. For example, the Commission eliminated implicit subsidies to payphones provided by local exchange carriers (LECs) that gave such companies an unfair competitive advantage compared to non-LEC payphone providers. Similarly, the Commission established non-structural safeguards to prevent Bell Operating Companies (BOCs) from discriminating in favor of their own payphones in the provision of local exchange service, as well as other measures designed to place all providers of payphone services on an equal competitive footing.

However, the existing access charge reform policies undermine significantly some of the progress made in the FCC's prior orders. The access charge reform orders, and specifically the imposition of PICC and high SLC charges undermines the goals and objectives of Section 276. In its *Payphone Reclassification Proceeding*, the FCC found that PSP (for marginal payphone locations) have on average less than 14 1+ interLATA calls per month. (*Third Report and Order*, at ¶ 151.)

Because PSPs have relatively few 1+ interLATA calls per month, but are still required to negotiate with a carrier to carry 1+ traffic, an IXC has little incentive or ability to negotiate with a PSP to reduce the per-minute charges for 1+ calls in amounts that would allow the PSP (or IXC) to recognize any savings resulting from lower per-minute access charges or lower per-minute rates.[3]

If a LEC imposes a $2.75 per month PICC on the payphone line, and the charge is passed through to the PSP, the PSP will not only pay the per minute charges negotiated between the IXC and the PSP, but will also pay a PICC that will be spread across very few calls. A $2.75 PICC allocated among 14 calls results in a PICC charge of almost $0.20 per call, plus per minute charges.

Because the IXC's merely pass through the PICC imposed on them by the LEC, the PICC and SLC revenue recovered by local exchange carriers allows the LECs to recover non-cost-based revenue for access services purchased by PSPs. The LECs' recovery of revenue that is not related to costs in providing access services to PSPs contradicts existing FCC orders that require

[3]Assuming there are 14 1+ calls for a marginal payphone, and each call lasted 4 minute, and the per minute savings to the IXC for access charges on these 14 calls was $0.005, the IXC would only save approximately $.25 per month in reduced access fees. If the LEC imposes a PICC fee of $2.75, the IXC's economic incentive is to pass on any PICC to the PSP.

the rates charged by LECs to be cost-based and compliant with the FCC's new services test pricing standard set forth at 47 C.F.R. § 61.49.

I. THE FCC SHOULD ADOPT A PAYPHONE SPECIFIC SLC AND PICC TO BE CONSISTENT WITH THE FCC'S NEW SERVICES TEST PRICING STANDARD ADOPTED IN THE *PAYPHONE RECLASSIFICATION PROCEEDING.*

In its *Payphone Reclassification Proceeding*, the Commission required that all incumbent LEC payphone tariffs filed at the state level be (1) cost-based, (2) nondiscriminatory, and (3) consistent with both Section 276 and the Commission's *Computer III* tariffing guidelines. The Commission adopted this objective pricing standard in light of its recognition that LECs have both the incentive and the ability to charge its payphone competitors excessive rates for network services.[4] Specifically, the Commission required

> LECs to file tariffs for the basic payphone services and unbundled functionalities in the intrastate and interstate jurisdictions as discussed below. LECs must file intrastate tariffs for these payphone services and any unbundled features they provide to their own payphone services. The tariffs for these LEC payphone services must be (1) cost based; (2) consistent with the requirements of Section 276 with regard, for example, to the removal of subsidies from exchange and exchange access services; and (3) nondiscriminatory. States must apply these requirements and the *Computer III* guidelines for tariffing such intrastate services.[5]

With respect to the requirement that payphone rates comply with Section 276 and the *Computer III* tariffing guidelines, the Commission has held that the rates assessed by LECs for payphone services tariffed at the state level must satisfy the requirements that the Commission

[4] *See Payphone Order* at ¶ 146 ("Because incumbent LECs may have an incentive to charge their competitors unreasonably high prices for these services, we conclude that the new services test is necessary to ensure that central office coin services are priced reasonably.")

applies to new interstate access services proposed by incumbent LECs subject to price cap regulation—this is the so-called "new services" test. The new services test is a cost-based test that establishes the direct cost of providing the service as a price floor. LECs may then add a "reasonable" amount of overhead to derive the overall price of the service. 47 C.F.R. § 61.49. Therefore, direct cost plus reasonable overhead establishes a price ceiling for LECs in providing access services to PSPs.

The new services test was initially established by the Commission in an effort to set the proper rates for basic service elements ("BSE") in the context of the Commission's Open Network Architecture ("ONA") proceeding. The pricing methodology was originally adopted by the Commission as a condition to allow LECs to offer enhanced retail services in competition with competitive enhanced service providers ("ESPs") in the Commission's *Computer III* proceedings. The new services test was established because, like its fear the LECs would charge excessive rates for network services to payphone providers, the Commission found that LECs had the incentive and the ability to charge excessive rates for BSEs used by ESPs. In its *Notice* initiating the ONA proceeding, the Commission discussed this concern:

> By identifying incremental costs, the [Bellcore Switching Cost Information System] model would provide a floor that ensures that existing access services, such as basic switching, are not subsidizing new, unbundled BSEs or qualified non-ONA services. However, the model produces only a cost suitable for determining the level below which BSEs should not be priced. It does not yield a cost suitable for establishing a maximum rate. We seek comment on whether such a ceiling would be necessary in light of the overall constraint on switched element revenues, and if so, how such a ceiling could be

[5] *Payphone Reconsideration Order* at ¶ 163.

developed.[6]

After reviewing the comments, the Commission adopted 47 C.F.R. § 61.49, which contains the "new services" test, as the method to determine not only the price floor but also the price ceiling:

> Although the price cap system has rules designed to ensure that the adjustments of existing prices will be reasonable, prior to the adoption of the interim new services test, it did not provide any specific tariff review showing to ensure that initial prices for "new" services were not unreasonably high. A net revenue test provides assurance that the initial price will not be set at a predatory level, but does not ensure that the initial rate will not be excessive. . . .
>
> As NYNEX recognizes, a cost-based upper bound can preserve carriers' incentives to innovate, if it permits them to earn a return on their total new investment commensurate with the risk they assume.
>
> [A] LEC introducing new service will be required to submit its engineering studies, time and wage studies, or other cost accounting studies to identify the direct costs of providing the new service, absent overheads, and must also satisfy the net revenue test. . . .

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[6] Creation of Access Charge Subelements for Open Network Architecture, *Notice of Proposed Rule Making*, FCC 89-105, 4 FCC Rcd 3983 (1989), at ¶ 20.

> Once the direct costs have been identified, LECs will add an appropriate level of overhead costs to derive the overall price of the new service.[7]

The new services test is a "bottoms-up" test that establishes a price ceiling to what LECs may charge for network services made available to PSPs. However, because LECs impose non-cost based SLC and PICC on PSP access services, the LECs are able to double-recover the purported loop costs incurred in providing services to PSPs.

In Michigan, Kentucky, and Ohio, the state public service commissions have conducted investigations to determine what the appropriate prices should be for payphone specific access services. In these investigations, the state commissions have reviewed the costs for the loops, ports, central office switching, and common expenses incurred in providing payphone-specific access services. The Michigan commission found that the existing rates for access services (without including any revenue from PICC or EUCL) more that exceeds the total costs of the loops and ports associated with PSP access services. (*In the matter of the Complaint of the Michigan Payphone Association, et al. v. Ameritech Michigan, et al.*, MPSC Case No. U-11756, March 8, 1999 Order, p. 9.)

The Kentucky Commission has also concluded that the total cost for loops, ports, switching and common expenses were recovered through the access line charges. (*In the matter of the Deregulation of Local Exchange Companies' Payphone Service*, Admin. Case No. 361, Order on Clarification.) The KPSC even concluded that the rates charged to PSPs would

[7] Creation of Access Charge Subelements for Open Network Architecture, *Report and Order and Order on Further Reconsideration and Supplemental Notice of Proposed Rule Making*, FCC 91-186 (released July 11, 1991), at ¶¶ 39-44 (emphasis added).

subsidize business and residential customers when the EUCL and PICC are included in the rates charged to PSPs. (*Id.*, at p. 6.)

In Ohio, the State Commission's investigation is pending a hearing after the Payphone Association of Ohio showed the Commission through discovery that Ameritech and GTE were charging PSPs rates that more than recovered the total cost of the loops, ports, and switching for PSP access services. (In the Matter of the Commission's Investigation into the Implementation of Section 276 of the Telecommunications Act of 1996 Regarding Pay Telephone Services, PUCO Case No. 96 - 1310- TP- COI, January 28, 1999 Order.)

In each of these states, the access charges for PSP services recovered the total cost of the loops, ports, switching and common expenses. In each of these states, the LECs also recover SLC's that range from $5.40 per month to $9.00 per month, and PICC charges of up to $4.53 per month. The additional PICC and SLC charges imposed on PSPs contradicts the FCC's mandate that the rates for access services be cost-based and compliant with the new services test pricing standard.

The prices for PSP access services are required by FCC order to be based on cost, and the PICC is clearly not a cost-based rate element. Adding non-cost based rate elements to the price of services that must be cost based is fundamentally inconsistent. The Commission must recognize that pricing for network services made available to payphone providers is different than the prices for services made available to business or residential subscribers. There is no requirement that prices for business or residential services be based on cost; there is a clear requirement that the prices for PSP services be based on cost. To resolve this inconsistent pricing dilemma the FCC should initiate a proceeding to identify specific PICC and SLC rates that would apply to PSP access lines in each state. PSP-specific PICC and SLC would conform the FCC's goal of access charge reform with its prior orders requiring that access services made available to PSPs be cost-based, and compliant with the new services test pricing standard.

II. IT IS APPROPRIATE FOR THE COMMISSION TO DEVELOP A SEPARATE PSP-SPECIFIC PICC AND SLC TO REFLECT THE DIFFERENCE BETWEEN PSPs, AND LEC END-USER SUBSCRIBERS SUCH AS BUSINESS AND RESIDENTIAL CUSTOMERS.

It is appropriate, in evaluating further access charge reform measures for low-volume users, for the Commission to recognize the distinct differences between PSPs and other classes of LEC subscribers. PSPs are not only low-volume 1+ users, but have been recognized by the FCC as being a different class of customer than residential and business customers. Yet, despite the distinction, PSPs have historically been treated as subscribers that subsidize high-cost customers. The Commission should initiate a rulemaking proceeding to develop a payphone-specific PICC and SLC for PSP access lines to correct this misclassification.

PSPs are distinct from business and residential customers for several reasons. First, as described above, the FCC has imposed a cost-based pricing standard for access services purchased by PSPs. The FCC has never suggested that either business or residential customers be provided access services at cost-based prices.

Second, PSPs purchase services from local exchange carriers and interexchange carriers and resell telecommunications services to end-users. The PSP's provide telephone services by marketing and selling their telephone services to end users, generally (for coin calls) at prices negotiated between an end user and the PSP. Business and residential subscribers do not sell telecommunications services. In order to promote the availability of telecommunications services, including payphone services, the Commission should prohibit LECs from double-recovering the cost of access services necessary for PSPs to make their own services available to customers.

Third, PSPs are required to contribute to the federal Universal Service Fund, pay federal telecommunications excise taxes, and contribute to the Telephone Relay Service (TRS) funds. These factors clearly separate PSPs from other traditional business and residential subscribers. If the SLC and PICC are intended to subsidize high-cost subscribers, the FCC should recognize that PSPs contribute directly to the Universal Service Fund, and these contributions should be accounted for in setting the prices for payphone-specific SLC and PICC.

Another factor that distinguishes PSPs from other classes of LEC subscribers relates to the necessity for many PSPs to choose "No-PIC" in order to minimize fraudulent calls being made over the LEC network. In its prior proceedings, the FCC has recommended that PSPs choose "No-PIC" in order to prevent dishonest end-users from completing fraudulent calls from the LEC's network. *United Artists Payphone Corporation v. New York Telephone Company*, FCC 93-387, 8 FCC Rcd 5563 (1993.) By choosing "No-PIC", a PSP prevents an end-user from completing "clip-on fraud" calls where an end user would access the LECs' network by attaching a phone to the network interface device and simply dialing 1+ calls. In these circumstances, the LEC is responsible for paying the fraudulent charges to the IXC. By choosing No-PIC, the PSP precludes such fraudulent calls. However, under the FCC's access charge reform scheme, the LEC is able to impose a $2.75 "no-PIC" fee against PSPs that choose no-PIC to prevent fraudulent calls. In light of the fact that PSPs already compensate LECs for the total cost of providing access services, the FCC should reconsider whether it is appropriate for LECs to recover a \$2.75 no-PIC (a non-cost-based rate element) fee where the PSP chooses no-PIC to avoid fraudulent calls.

The Commission should initiate further investigations into what the appropriate treatment should be for low-volume 1+ presubscribed carrier customers. That investigation should also investigate the need to develop a PSP-specific SLC and PICC that reflects the cost-based pricing standard imposed on LECs for PSP access services, as well as the role of the PSP as a provider of telecommunications services. PSPs are currently treated inconsistently as a "business" subscriber and a "telecommunications" service provider. PSPs subsidize the "high-cost" customers by 1) overpaying for access services provided by local exchange carriers, despite the FCC's mandate that these services be priced at cost, plus a reasonable allocation for overhead; 2) paying SLC and PICC charges that allow LECs to double-recover the loop costs; and 3) contributing directly to the Universal Service Fund and other public interest funds (*i.e.* the TRS fund.) The Commission should reevaluate the historical treatment of PSPs, and develop a cost-based PICC and SLC that is consistent with the Commission's orders in its other proceedings.

Wherefore, the Kentucky Payphone Association, the Michigan Pay Telephone Association, and the Payphone Association of Ohio respectfully request that the Commission initiate a rulemaking proceeding to identify the appropriate subscriber line charges and presubscribed interexchange carrier charges that should apply to payphone access services under the FCC's prior orders and Section 276 of the Federal Communications Act.

Respectfully submitted,

The Kentucky Payphone Association, the Michigan Pay Telephone Association, the Payphone Association of Ohio.

Dated: September 20, 1999

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